

UK Emissions Trading Scheme (UK ETS) Authority Response to consultation on amendments to existing civil penalties

Introduction

The UK ETS was established on 1st January 2021 by the UK ETS Authority (UK Government, Scottish Government, Welsh Government and the Department of Agriculture, Environment and Rural Affairs for Northern Ireland (DAERA)). We are committed to increasing the ambition of the scheme and ensuring it plays a crucial role in achieving ambitious climate targets across the UK.

The UK ETS Authority (the Authority) has previously consulted on changes to scheme civil penalties: in the [Authority Response to the Developing the UK ETS Consultation](#), the Authority committed to the inclusion of one penalty relating to the failure to submit information to regulators detailed in article 27A of the Greenhouse Gas Emissions Trading Scheme Order 2020 as amended (the Order). We also committed to introducing a new 'deficit notice', backed up with a penalty for non-compliance. This deficit notice is a targeted mechanism to enforce the requirement on operators and aircraft operators to surrender any deficit of allowances, which is consistent with the policy principle that allowances should always be surrendered to cover emissions.

The Authority intends to fulfil our commitments to legislate for these changes before 1 January 2025. Alongside these planned changes, the Authority also recently consulted on proposals for several other minor amendments to existing civil penalties in a consultation which closed on 8th March 2024.

Summary of proposals

In the UK ETS Penalties Consultation, the Authority consulted on the amendments to four existing civil penalties within the scheme. These have been proposed to ensure that civil penalty amounts are comparable to penalties of a similar nature within the scheme, are proportionate to the type of breach and operate as intended. The proposed amendments were:

1. Punitive element of penalties related to operating without a permit

There are three penalties within the Order relating to the breach of operating without a permit. These are:

- Article 50 – Installations: carrying out a regulated activity without a permit contrary to article 26 (Installations: requirement for permit to carry out regulated activity).
- Article 57 – Hospital and Small Emitters: failure to notify when ceasing to meet criteria.
- Article 60 – Ultra-Small Emitters: failure to notify where reportable emissions exceed maximum amount.

Each of these penalties is calculated by assessing (a) avoided costs as a result of the breach and (b) a punitive element. Since the directions for articles 50 and 60 came into force on 6th October 2023, both these civil penalties share the same approach to the punitive element regulators may impose. The Authority proposed that the same punitive element regulators may impose as part of these civil penalties be applied to article 57, in the instance that an operator fails to give notice on or before 31st October in the default year and there is a ‘penalty year’¹. In this case, the regulator may increase the civil penalty of the avoided compliance costs for each penalty year amount by 10% or £2500, whichever is higher. This clarifies that the penalty consists of a cost avoided element and a punitive element, enabling regulators to apply a consistent punitive element across all three penalties.

Additionally, where there is no ‘penalty year’, the Authority proposed that the civil penalty for an operator failing to give notice on or before 31st October in the default year should be lowered to £2500. This is to ensure the penalty is proportionate to the breach.

2. Penalties relating to under-reporting

Articles 52(4) to (6) (Failure to surrender allowances) and 56 (Hospital and small emitters: under-reporting of emissions) of the Order both contain penalties related to under-reporting discovered after submission of an annual emissions report. Under the main UK ETS, if an installation’s verified reportable emissions in a scheme year are discovered to exceed their verified reportable emissions and this resulted in a failure to surrender allowances by the relevant deadline, the penalty in article 52(10) applies. In addition, the operator is required to surrender the excess allowances to cover the unreported emissions. Where a hospital or small emitter (HSE) does not include emissions in its annual emissions report for a scheme year, the penalty in article 56 applies to the unreported emissions. In addition, the operator may be liable to the penalty in article 54 (Hospitals and small emitters: exceeding emissions target) for reportable emissions exceeding its emissions target.

As they currently function, the article 56 penalty is disproportionately punitive when compared to the article 52(10) penalty. The Authority considers that an under-reporting breach for HSEs is less serious than a similar breach by an operator in the main UK ETS because the breach has less impact on the integrity of the scheme’s UK Allowance market. In addition, it is intended that there is a lower compliance burden on HSEs compared to operators in the main UK ETS. The Authority therefore proposed the following amendments to how the civil penalty is calculated:

¹ ‘Penalty year’ is defined in [article 57](#) of the Greenhouse Gas Emissions Trading Scheme Order 2020 as a scheme year for which the installation is an HSE but no longer meets the criteria to participate in this scheme.

- To remove the link to the carbon price for the scheme year from article 56.
- To set the value of the article 56 penalty for unreported emissions at £10 per tonne of carbon dioxide equivalent x an inflation factor.

The Authority also proposed not to remove the additional sum of £5,000 as part of the article 56 penalty as it may be appropriate for regulators to apply this in certain circumstances, such as where an HSE has benefitted financially as a result of a breach.

The proposal would mean a more proportionate approach is taken by regulators for penalties given under article 56. Regulators will still have discretion to apply the additional penalty of £5000.

3. Inflation Factor Calculation

Currently, penalties given under article 52, article 53 (Installations: failure to transfer or surrender allowances where underreporting discovered after transfer) and the proposed penalty in article 56 refer to an inflation factor calculated as follows:

$(CPI_2 - CPI_1) / CPI_1$ or 1, whichever is greater, where –

- CPI_2 is the consumer prices index for the most recent March for which the consumer prices index is published when the penalty notice is given.
- CPI_1 is the consumer prices index for March 2021.

This base figure is used as the first CPI published after the scheme came into force.

The Authority proposed two changes to the above inflation factor calculation. The first was a technical change to correct the inflation factor calculation to ‘ $CPI_2 - CPI_1$ or 1, whichever is greater’. This would enable the inflation factor to function as intended, so that penalties change accurately in line with inflation and remain proportionate. The second was to amend the definition of CPI_2 to the consumer prices index for the most recent March for which the consumer price index is published when the breach occurred. This will ensure that the appropriate and most fair rate of inflation is used.

4. Alignment of under-surrender penalties

In the [Authority Response to the Developing the UK ETS Consultation](#), the Authority set out its intention to introduce a deficit notice, issued where an operator or aircraft operator fails to surrender allowances to cover its reportable or aviation emissions by the relevant deadline. Failure to comply with a deficit notice would result in a penalty consisting of a proportionate mandatory penalty and an additional discretionary daily penalty that may be applied by regulators. Currently, the article 53 penalty (for failure to transfer or surrender allowances where under-reporting of allowances is discovered after a permit transfer) is different to the proposed deficit penalty and contains no daily penalty element. The Authority proposed to amend article 53 when the deficit notice penalty is introduced to align it with the new deficit notice penalty. The proposal will mean a more consistent approach is taken by regulators for all penalties given in association with under-surrender.

Questions

- 1) Do you agree with the recommended proposals to ensure consistency across the punitive elements of articles 50, 60 and 57?
- 2) Do you agree with the recommended proposals to ensure a more proportionate penalty is given to hospitals and small emitters in relation to article 56?
- 3) Do you agree with the proposed amendments to article 52 to ensure that the inflation factor is correctly applied and is based on the CPI up to the date of the breach occurred?
- 4) Do you agree with the recommended proposals to ensure the upcoming Deficit Notice provisions and penalties apply in both non-transferring and transferring scenarios?

Summary of Responses

We received 2 responses to question 1 regarding introducing greater consistency across the punitive elements of penalties relating to operating without a permit. 1 respondent welcomed a reduction in this element for article 57, whilst the other summarised that the articles were not applicable to their current business scope.

We received 2 responses to question 2 regarding the proposal to ensure a more proportionate penalty is given to hospitals and small emitters in relation to article 56. 1 respondent highlighted that the current penalty was too severe for small emitters and thus agreed with the proposal. The second respondent summarised that the articles were not applicable to their current business scope.

We received 2 responses to question 3. Both agreed with the proposed amendment to article 52 to amend CPI and to link to the date of the breach occurring.

We received 2 responses to question 4. One of the two respondents was supportive of the approach to align the upcoming deficit penalty with the article 53 penalty. The respondent that did not agree highlighted that the introduction of a daily penalty would be unfair in a situation where a permit is transferred. They noted that in this case an operator could be subject to due diligence, which might extend timelines and could take a long time for legal teams to process.

There was an additional respondent who did not comment on the individual questions, however shared views that any changes which would allow for regulator discretion, proportionality and consistency when addressing under and over-reporting instances would be welcome. The respondent also highlighted an interest in further guidance to industry.

The Authority Response

The Authority will be moving forward with the amendments as proposed above with relation to the punitive element of penalties related to operating without a permit, under-reporting penalties and the alignment of under-surrender penalties.

In order to add consistency and fairness to the punitive elements of penalties relating to operating without a permit, we will also be removing the £2500 sum from article 60(2)(a) (Ultra-small emitters: failure to notify where reportable emissions exceed maximum amount). The punitive element of this penalty will be calculated in accordance with the directions published on 6th October 2023². The Authority deems this sufficiently punitive and to add an additional £2500 would be inconsistent with the punitive element of article 50(2) (Installations: carrying out regulated activity without permit contrary to article 26).

The Authority will be moving forward with the amendment to the inflation factor calculation with one minor change to the proposal, which will be to redefine CPI₂ as the carbon price associated with the month preceding the month in which the allowances are required to be surrendered. This will ensure the most up to date price is used in the inflation factor calculation, and that consistency is applied to the calculations in cases where a price for that month has not yet been published.

The Authority recognises the concern raised about the introduction of a daily penalty under article 53, but notes that the application of the daily penalty is subject to the discretion of the regulators which mitigates against these concerns. We will aim to implement the above amendments by 1st January 2025, alongside the introduction of the deficit notice and associated penalty, and failure to submit information penalty (as set out in the 2023 Authority Response).

² <https://www.gov.uk/government/publications/uk-emissions-trading-scheme-ministerial-directions-to-the-regulators>
<https://www.daera-ni.gov.uk/articles/emissions-trading-schemes-fees-charges-and-civil-penalties>
<https://www.gov.scot/publications/greenhouse-gas-emissions-trading-scheme-order-2020-article-606-ministerial-direction/>
<https://www.gov.wales/direction-natural-resources-body-wales-article-606-greenhouse-gas-emissions-trading-scheme-order>